THE

QUARTERLY JOURNAL

OF

ECONOMICS

NOVEMBER, 1907

MORTGAGE TAXATION IN WISCONSIN.

SUMMARY.

The taxation of mortgages condemned by most economists, 1–3; but retained on the statute books of most States, 3–4; the experience of Wisconsin throws light upon this conflict of authority and practise, 4–12; and indicates that taxation of mortgages under the general property tax will prove innocuous in some places, 12–15; but harmful in others, 16; the conditions under which shifting will probably occur, 17–20; leading to the conclusion that mortgage taxation should be limited in rate, if imposed at all, 21; and is generally inexpedient not because the tax is necessarily shifted, 22, 23; but because it is part of a vicious system of personal taxation, 25–27.

AMONG the academic economists who have expressed decided opinions concerning mortgage taxation, the seeker for guidance in this troublesome problem finds not only a normal difference of opinion concerning remedies and reforms, but curiously contradictory impressions about the fundamental facts which condition the problem. According to Professor Plehn, "mortgages are generally easily taxable."[1] According to Professor H. C. Adams,

[1] Introduction to Public Finance, p. 225.

"it is impossible for assessors to discover mortgages."[1] Professor Ely sees in this problem an unpleasant alternative between overtaxing the debtor and permitting the creditor to escape. According to Professor Daniels, however, the mortgagees actually are tempted to rush into debt in order to escape taxation.[2] Between the Massachusetts system and the California system the average economist usually finds all the difference that distinguishes virtual mortgage exemption from effective (even tho costly and undesirable) mortgage taxation, but in the same breath Professor Seligman commends both,[3] seeing between them apparently a bond of real economic kinship.

And so similarly with respect to the vital question of shifting. Many, if not most, authorities agree with Professor Plehn that "shifting is always possible when any one form of capital is taxed, leaving other forms untaxed,"[4]— that is to say, in practically every commonwealth. On the other hand, there is a respectable and erudite minority who contend that a tax on mortgages will be shifted only in part or shifted in some locations and not shifted in others, altho the degree or places in which shifting is likely to take place are not specified.

On the whole, however, there is something approaching a consensus of opinion against any form of mortgage taxation now employed in the United States.[5] Casual reference by

[1] The Science of Finance, p. 442.

[2] This unusual, not to say startling, construction of the problem is worthy of full description: "Another piece of unfairness involved in the general property tax is that those who hold their property unencumbered by mortgages or debts pay taxes on the entire property. Those whose property, on the contrary, is mortgaged, pay taxes only on the unencumbered part of their estate; and, if the mortgagee pays any tax at all upon the mortgage, he is probably more honest than most of his class. The result of the system is a premium on indebtedness and an incentive to dishonesty" (p. 124).

[3] Essays on Taxation, pp. 101–103.

[4] Introduction to Public Finance, p. 165.

[5] Particularly if we disregard some of the earlier and premature indorsements of the California system which have since been rescinded by their authors.

writers in other branches of economic investigation indicate their belief that the problem is finally settled in favor of exemption. Thus Professor Zartmann, in a field so far removed from mortgage taxation as that of insurance investments, feels justified in asserting, without argument, that mortgage taxation is unwise. "That mortgages should not be taxed has often been demonstrated by experience. A loan upon real estate does not create any new wealth, and to tax both the real estate and the mortgage is double taxation. It has been found that the borrower gains when the tax is placed upon real estate and when no attempt is made to levy upon the mortgage."[1]

Legislation upon the subject, however, is strongly at variance with economic doctrine. Among the laws on the subject, as among the theories, we find a normal difference of method, with a large majority, however, persisting in the system of double taxation. Alabama, Virginia, New York, and Minnesota levy recording taxes, paid once for all when the mortgage is recorded, and collected alike on money borrowed from resident and non-resident mortgagees. In the above States, mortgages are effectively taxed, whether the results are harmful or beneficial. At the other extreme are commonwealths like Idaho, Washington, Colorado, New Jersey, Connecticut, Massachusetts, Wisconsin, Arizona, Alaska, Hawaii, and Maryland, in which virtual exemption of mortgages is accomplished either by specific exemption, as in Idaho and Washington, or by taxation of the property and the mortgage as a unit in some of the many ways which in practise relieves the mortgage and mortgagee from taxation.[2] In all other States of the

[1] Zartmann, The Investments of Life Insurance Companies, p. 224.

[2] In ten counties in Maryland a tax of 8 per cent. is imposed on the annual interest earnings of mortgage loans. The Connecticut system is rather complex, but results, I understand, in virtual exemption. In most of the above commonwealths mortgages owned by residents, but secured by property situated in other States, are legally subject to taxation, tho in practise they escape. The California law is at present, to an outsider at least, in great confusion, owing to the repeal of the clause

union the system of so-called double taxation is employed. Property is taxed at its situs to the owner: the mortgage is taxed as personal property to the mortgagee at his domicile. In Indiana the mortgagor is allowed to deduct from the value of his real estate the amount of any mortgage indebtedness, provided such mortgage indebtedness does not exceed $700, nor one-half the value of the real estate; and in Pennsylvania the tax upon mortgages is limited to $\frac{2}{5}$ of 1 per cent. The old method of double taxation, then, is still employed in about three times as many States as all other methods combined. The system which is the particular *bête noire* of the economist and the creditor classes[1] generally is still distinctively the American system.

Upon the real character and persistent retention of what I shall hereafter refer to as the "double tax method" of mortgage taxation the recent history of mortgage taxation in Wisconsin throws particular light, and the remainder of this paper will be devoted to an analysis of its workings. In discussing the double tax method, it is very necessary to recall and constantly keep in mind the following familiar facts concerning its operation. (*a*) In most States mortgage credits may be offset or cancelled by *bona fide* debts of the mortgagee; (*b*) the tax does not reach non-resident mortgagees nor, usually, domestic banks, trust companies, insurance companies, and a number of other corporations subject to gross receipts, license, or other forms of special taxation; (*c*) practically, the only class of mortgages which the assessor

of the Constitution (Sect. 5, Art. XIII.) which prohibited contracting out. In Virginia, mortgages are also taxable under the property tax, but the rate is limited to 45 cents on the $100.

[1] Carefully framed inquiries submitted to 478 Wisconsin bankers and real estate dealers elicited the fact that fully 70 per cent. earnestly oppose the double tax method and recommend exemption, altho a large majority of the bankers believe that the double tax method would help their own business.

can hope to reach are those secured by property situated within the State and owned by taxable residents of the State, while in practise the average assessor will fail to reach a large proportion even of this restricted class.

Coming to the specific topic of mortgage taxation in Wisconsin, it is fortunately possible to lay the historical basis of the analysis in a few sentences. On the statute books, at least, the double tax method reigned supreme from the time Wisconsin became a State until May 23, 1903. During this long period, however, the assessment of mortgages was exceedingly perfunctory. In 1889, for instance, the moneys and credits assessed in the State (representing largely real estate mortgages) amounted to only $6,513,050, whereas the federal census investigation showed a mortgage debt of $82,461,393 on January 1 of the same year. About 1898, however, great public interest was aroused in the subject of taxation in Wisconsin, and in 1901 legal provision was made for the appointment in each county of a supervisor of assessment with the special purpose of improving the administration of the property tax. About the same time, moreover, the Wisconsin Tax Commission got well under way, bringing pressure to bear all over the State in the interests of better and more thorough assessment work. The results are strongly marked in the financial statistics of this period. Between 1900 and 1902, inclusive, the State assessment (made by the Tax Commission after 1900) was raised from $630,000,000 to $1,504,346,000. The aggregate local assessment rose from $746,022,932 in 1900 to $1,369,811,000 in 1902. The assessment of moneys and credits increased in even greater proportion, moving from $25,865,940 in 1900 to $35,598,181 in 1901 and to $73,055,102 in 1902. Not less than $50,000,000 of the last amount, and probably more, consisted of real estate mortgages, most of which

had been listed in the particularly active assessment of 1902. In all probability between 30 and 40 per cent. of the taxable mortgages of the State were on the assessment rolls in the year 1902. As might be expected, however, the assessment of moneys and credits was very uneven in different counties of the State. In Douglas County, for instance, practically none, while in Grant County nearly all of the mortgages subject to taxation were placed upon the assessment rolls.

In their report to the legislature of 1903, however, the Wisconsin Tax Commission made a vigorous plea for the exemption of credits,—one of the three members dissenting,—and on May 21, 1903, the legislature repealed the old law and substituted the Massachusetts method, by which every mortgage is taxed as an interest in the property by which it is secured, the parties to the mortgage being permitted to arrange between themselves who shall pay the taxes. Such laws, it is generally understood, work virtual mortgage exemption. Of the 50,330 mortgages recorded in Wisconsin in 1904, only 31—according to reports of the registers of deeds—failed to contain the familiar covenant by which the mortgagor assumed the taxes on the mortgagee's interest.

The exemption of mortgages took effect before the assessment of 1903 had been completed. In consequence the assessment of moneys and credits fell from $73,055,102 in 1902 to $24,118,031 in 1903. Some complaint was heard from counties which had in the past derived a revenue from this form of taxation, and at each subsequent session of the legislature bills have been introduced looking to the repeal of the present law and the substitution of various methods of mortgage taxation. Most of these bills, however, have never reached a vote, and none of them has come near to adoption. In his message to the legislature of 1907 Governor Davidson advised

the repeal of the present law, but no action was taken. Since the exemption of mortgages in 1903, therefore, interest in the subject has been active, but not intense. New legislation, while not imminent, is not unlikely; and, to secure information which would guide the legislature to wise action in the matter, the Tax Commission gathered during 1905 and 1906 comprehensive statistics of mortgages in Wisconsin, and published the results—without special analysis of their bearing upon the mortgage problem—in their report to the legislature in 1907. The present paper consists largely of an interpretation of the facts presented in that report,[1] to which the reader is referred for additional statistical detail bearing upon the topics hereafter discussed. For convenience, however, the most important statistical results of this investigation are reproduced in the table on the following page:—

[1] Third Biennial Report of the Wisconsin Tax Commission.

INTEREST RATES ON COMMERCIAL BANK LOANS AND REAL ESTATE MORTGAGES IN ELEVEN WISCONSIN COUNTIES AND FOUR ADJOINING COUNTIES IN FOREIGN STATES, BY SEMI-ANNUAL PERIODS, 1900–1906.

Periods.	Commercial Bank Loans.	Interest Rates on Mortgages.																	
		Eleven Wisconsin Counties.	Wisconsin Border Counties.	Foreign Counties.	Grant County.	Clayton County, Ia.	Lafayette County.	Jo Daviess County, Ill.	Marinette County.	Menominee County, Mich.	St. Croix County.	Washington County, Minn.	Ashland County.	Clark County.	Dane County.	La Crosse County.	Milwaukee County.	Ozaukee County.	Waushara County.
Jan., 1900–June, 1906	5.50	5.36	5.83	5.63	5.80	5.69	5.34	5.19	6.27	6.60	6.07	5.96	6.43	5.97	5.24	5.56	4.95	4.58	5.52
Jan., 1900–Dec., 1902	5.51	5.29	5.75	5.55	5.61	5.57	5.30	5.16	6.33	6.55	6.00	5.98	6.51	5.85	5.14	5.58	4.93	4.63	5.50
Jan., 1903–June, 1903	5.47	5.44	5.90	5.62	6.15	5.75	5.39	5.17	6.54	6.65	5.91	6.03	6.30	6.07	5.28	5.63	5.02	4.57	5.52
July, 1903–June, 1906	5.50	5.42	5.89	5.71	5.87	5.81	5.37	5.23	6.19	6.64	6.14	5.92	6.40	6.04	5.31	5.53	4.96	4.52	5.53
Jan.–June, 1900	5.78	5.31	5.73	5.56	5.53	5.68	5.44	5.28	6.25	6.19	6.04	6.08	6.99	5.94	5.25	5.64	4.83	4.98	5.84
July–Dec., 1900	5.53	5.29	5.97	5.74	5.64	5.58	5.70	5.27	6.48	6.59	6.08	6.14	6.65	5.80	5.15	5.60	4.95	4.82	5.68
Jan.–June, 1901	5.40	5.30	5.67	5.44	5.53	5.56	5.24	5.14	6.51	6.51	6.20	6.00	5.78	5.99	5.08	5.59	5.04	4.50	5.69
July–Dec., 1901	5.40	5.25	5.74	5.59	5.67	5.50	5.17	5.16	6.42	6.66	5.90	5.98	6.49	5.79	5.04	5.40	4.98	4.44	5.39
Jan.–June, 1902	5.54	5.21	5.63	5.42	5.62	5.43	5.15	5.05	6.17	6.70	5.84	6.15	6.76	5.76	5.12	5.62	4.86	4.52	5.13
July–Dec., 1902	5.46	5.38	5.98	5.81	5.90	5.82	5.59	5.21	6.24	6.68	6.03	5.62	6.39	5.85	5.26	5.63	4.95	4.43	5.39
Jan.–June, 1903	5.47	5.44	5.90	5.62	6.15	5.75	5.39	5.17	6.54	6.65	5.91	6.03	6.30	6.07	5.28	5.63	5.02	4.57	5.52
July–Dec., 1903	5.65	5.37	5.99	5.92	6.07	5.96	5.08	5.51	6.19	6.67	6.06	5.76	6.55	5.91	5.34	5.33	4.96	4.79	5.60
Jan.–June, 1904	5.40	5.48	5.86	5.71	5.93	5.84	5.45	5.28	6.30	6.73	6.10	6.01	6.39	6.01	5.39	5.66	4.97	4.40	5.52
July–Dec., 1904	5.62	5.51	6.10	5.97	5.93	6.16	5.38	5.23	6.30	6.62	6.27	5.94	6.50	6.23	5.48	5.66	5.00	4.50	5.58
Jan.–June, 1905	5.38	5.33	5.79	5.58	5.73	5.72	5.44	5.19	6.21	6.48	6.25	5.91	5.90	6.15	5.23	5.32	4.88	4.61	5.55
July–Dec., 1905	5.40	5.43	5.91	5.91	5.85	5.84	5.24	5.29	6.25	6.73	6.09	5.98	6.69	6.00	5.28	5.64	4.98	4.55	5.52
Jan.–June, 1906	5.52	5.40	5.84	5.57	5.89	5.67	5.31	5.18	5.95	6.66	6.08	5.91	6.49	5.92	5.26	5.55	4.99	4.25	5.42

The adequacy of the statistical basis upon which the above figures rest may be gathered from the statement that the mortgages recorded in the eleven Wisconsin counties during the six and one-half years under investigation numbered 51,710, amounting to $64,146,219. In the six months January 1–June 30, 1903, in the eleven counties the mortgages numbered 4,091, amounting to $5,454,801. There were 29,996 bank loans, aggregating $36,441,689.

Bearing in mind the main events recited in the preceding paragraphs—the perfunctory assessment up to 1901, the active search by the assessors of some counties for mortgages in 1902, and the exemption of mortgages from taxation in 1903,—the figures in this table, which have been arranged so as to contrast the period of partial taxation with the period of complete exemption, take on a real meaning. Our principal concern, naturally, is with the subject of shifting. Shifting takes place in two ways, by an increase in interest rates or by the insertion in mortgage instruments of covenants providing for the assumption of all taxes on the mortgage by the borrower. The latter form of shifting may in this case be disregarded, since it was found in the Wisconsin investigation that prior to 1903 such covenants were practically never employed in the eleven counties represented in the table. Confining attention, then, to the interest rate on mortgages (hereafter referred to as the mortgage rate), the figures as they stand, I think, make out a strong *prima facie* case against shifting. The general level of interest rates indicated by the figures for bank loans (column 1) and wholly uninfluenced by tax legislation was about the same before as after the passage of the mortgage tax law of May, 1903. The average mortgage rate for the eleven Wisconsin counties was about the same also.[1]

The difference in rates, which is so slight as to be negligible, merely emphasizes this conclusion. The general level of interest rates indicated by the bank rate was rather lower after than before 1903. The general level of mortgage rates was higher rather than lower after 1903. It is only fair to say that, if we examine the figures closely, it is easy

[1] The showing of the figures is borne out by the general testimony of Wisconsin bankers. In answer to the question whether the mortgage rate had been substantially lower after the repeal of the law, 140 of the 195 bankers who replied to this question answered that it had not, although a very large majority of the same bankers were in favor of the repeal, and believed that the reimposition of mortgage taxation of any kind would raise interest rates and prove disastrous in other ways.

to detect plain evidence that the vigorous assessment of 1902 and the agitation of the subject during the legislative session of 1903 did affect the rate. Mortgage rates rise in almost every county in the last half of 1902 and the first half of 1903, whereas bank rates fall in the same period. And other evidence may be gleaned by close scrutiny of the figures, tending to modify slightly the apparent (and obviously absurd) conclusion that the effect of abolishing the tax on mortgages was to raise mortgage rates. But all these modifications and qualifications are insufficient, after all, to vitiate the primary lesson of the figures, that mortgage rates, in company with interest rates generally in Wisconsin, were at practically the same level before and after the exemption of mortgages in May, 1903. And as I understand the import of the theory of shifting generally accepted by advocates of exemption, this should not be the case. The general liability of mortgages to taxation and the actual taxation of one-fourth or one-third of the taxable mortgages, together with the consequent agitation and alarm of creditors, ought, according to the advocates of exemption, to raise mortgage rates in an appreciable and harmful degree. If this is not the theory of shifting accepted by the advocates of exemption, then that theory contains nothing practically adverse to the double taxation of mortgages.[1]

The preceding comparison, however, is inconclusive because the taxation of mortgages was not thorough in all of the eleven counties even in 1902. Fortunately, there is one county in which mortgages were fully taxed in 1902, the county of Grant, to which special attention is now asked. Conditions in that county were extraordinary. In 1900, assessments were exceedingly low,—real estate at

[1] In estimating the harmful effects of shifting, it is interesting to note that the taxation of mortgages in 1902 and the agitation in the first half of 1903 affected large mortgages more quickly and more severely than small mortgages. *Cf.* Third Biennial Report of the Wisconsin Tax Commission, p. 343.

something like one-third of true value, and only \$357,996 of moneys and credits on the tax rolls. In 1901 and 1902, however, the assessors made a campaign almost unprecedented in the financial history of Wisconsin, pushing the total local assessment from \$9,376,425 in 1900 to \$22,937,883 in 1901 and to \$32,591,637 in 1902. In the latter year the local assessment of real estate was actually higher than the figure placed upon it by the State Tax Commission, which body, in equalizing county assessments of real estate, places the figures at full value, based upon elaborate and careful investigation. The assessment of moneys and credits, just a little more than \$350,000 in 1900, was raised to \$1,410,600 in 1901 and to \$4,192,668 in 1902, averaging \$107.83 per capita and constituting 18 per cent. of the true value of real estate as fixed by the Tax Commission. Careful estimates lead me to believe that not less than 90 per cent. of the mortgages legally subject to taxation in Grant County in 1902 were on the tax rolls. The general assessment was extraordinarily high for so large a district as a full-sized county; and there was considerable agitation, discussion, and feeling. The movement of the mortgage rate under such conditions ought to constitute about as fair a test of the possibility of shifting as is possible to secure.

An inspection of the mortgage rates for Grant County indicate that they were raised somewhat, but nothing like so much as the rate of taxation. The effective assessment of mortgages in Grant County began in the spring of 1901. The average rate of taxation for 1900, about the same as that to which they had been accustomed for some years and on the basis of which they were paying taxes in 1901, was between $2\frac{1}{2}$ and 3 per cent. Nevertheless, the mortgage rate was exactly the same in the first half of 1901 as in the first half of 1900, and only $\frac{3}{100}$ of 1 per cent. higher in the last half of 1901 than the last half of 1900.

During 1902 the assessment of mortgages was carried out so thoroughly that practically all mortgages subject to taxation were on the rolls. The rate of taxation in 1901 (payable in 1902) was 1.215 per cent. Mortgage rates, however, were less than $\frac{1}{5}$ of 1 per cent. higher in 1902 than in 1901. In the first half of 1903, during the discussion of the subject in the legislature, the mortgage rate in Grant reached its highest point, 6.15 per cent. If we accept the difference between the rate for the first half of 1900 and the rate for the first half of 1903 as a maximum measure of the elevation of mortgage rates due to taxation, agitation and uncertainty, then the conclusion is that interest rates were raised $\frac{62}{100}$ of 1 per cent. in a county which for many years had been accustomed to a tax rate of approximately $2\frac{1}{2}$ per cent. and which for the year or two immediately preceding had been accustomed to a tax rate of a little over 1 per cent. (the average tax rate was 2.87 per cent. in 1900 and 1.028 per cent. in 1903). Moreover, there are strong indications that during this period the general level of interest rates was slowly rising in the section of the country immediately surrounding Grant County from causes wholly unrelated to taxation. Clayton County, Iowa, Jo Daviess County, Illinois, and Lafayette County, Wisconsin, are all in the immediate vicinity of Grant County. In all of these counties, interest rates were higher in the last half of 1902 and the first half of 1903 than, on the average, of the three years 1900–02, inclusive, while in none of them, with the exception of Lafayette and Grant, was there any special increase in the assessment of mortgages during the period under consideration.

A somewhat similar condition of affairs is found in Lafayette County, which immediately adjoins Grant. The assessment of moneys and credits, \$160,114 in 1900, was raised to \$1,473,148 in 1902, in which year I estimate that

somewhere from 55 to 65 per cent. of the taxable mortgages were on the assessment rolls. The total local assessment rose from about six millions in 1899 to about twenty-three millions in 1902. Here, also, the statistics indicate that the vigorous assessment of 1902 and the agitation in the spring of 1903 exercised only the smallest kind of influence upon the mortgage rates. In the last half of 1902 mortgage rates rose to 5.59 per cent. for instance; but this rate is lower than the rate for the last half of 1900, and in the spring of 1903, when rates should have been at a maximum, they fell to 5.39 per cent., only nine points higher than the average for the three years 1900–02. The Lafayette figures show unmistakable evidence of the effects of the disturbances of 1902–03, but those effects are so minute, particularly when we take account of similar movements in the adjacent counties of Jo Daviess and Clayton, in which there was no marked increase in the assessment of mortgages, that they are practically negligible.

Lafayette County, Wisconsin, Jo Daviess County, Illinois, Grant County, Wisconsin, and Clayton County, Iowa, are grouped close together in that section of the country where Illinois, Iowa, and Wisconsin touch shoulders. All of these counties are, for this section of the world, comparatively old and well developed, altho the two foreign counties, Jo Daviess and Clayton, are perhaps a little richer and better developed than their respective neighbors, Lafayette and Grant. With respect to mortgage taxation these counties are both similar and dissimilar. In Jo Daviess, Illinois, mortgages have been separately taxed as credits for the entire period under discussion, but the assessment has been exceedingly slack, probably not more than one-fourth of the taxable mortgages being reached. In Clayton County, Iowa, on the contrary, where the double tax method is also in force,

the redoubtable tax ferrets have been at work throughout the entire period, and a large majority of the taxable mortgages—probably not less than 85 per cent.—have been assessed and taxed without interruption. In the two Wisconsin counties, as will be remembered, mortgages were taxable, but not effectively taxed in 1900; taxable and partially taxed in 1901; taxable and well taxed in 1902; and exempt from taxation after May, 1903. Compare now the movement of mortgage rates in these four counties, which are grouped together in the table, and the student will find it exceedingly difficult to explain results on any theory of mortgage taxation which insists upon shifting. Jo Daviess has the lowest rate and, on the whole, shows the most favorable movement. Clayton County with full taxation of mortgages has lower rates than its neighbor, Grant, and the increase in the interest rate has been less in Clayton County than in Grant County, altho Grant moved from a condition of taxation to one of exemption, while Clayton has had effective taxation all the time. In interpreting these figures, it is important to remember that, except in the Wisconsin counties before 1902, the average rate of taxation was low, just about 1 per cent.

Space will not permit a thorough-going discussion of all the factors which lead the writer, at least, to the emphatic conclusion that in these counties during the period under investigation the theory of shifting sanctioned by those writers who oppose all forms of mortgage taxation is wholly discountenanced. Much additional evidence, however, may be secured by the reader who is interested in minute details of the comparison in Chapters VI. and VIII. of Appendix B to the Third Biennial Report of the Wisconsin Tax Commission. Among other facts brought out by the material there presented may be found interesting evidence to the effect that, while the effective taxation of

mortgages in Clayton, Grant, and Lafayette Counties exercised a noticeable influence in reducing the percentage of mortgages borrowed from persons resident within the State, and consequently taxable within the State, that reduction, nevertheless, was not very serious. In Clayton County, for instance, 80.5 per cent. of the money borrowed on real estate security in the first three years of the investigation was secured from lenders resident within the county, while in the last three years only 76.8 per cent. came from the same territory. In Grant County, similarly, during the stormy days which marked the first six months of 1903, the percentage of mortgages borrowed outside the county rose to 18.4 per cent., whereas the similar proportion for the six and one-half years investigated was only 17.2 per cent. Here, again, there are effects of the kind expected, but so slight as to be negligible. While we are on this topic, it may be well to add that in the eleven counties as a unit phenomena similar to those described above are traceable in the figures describing the residence and character of mortgagees. During the first half of 1903 the proportion of mortgages borrowed outside the State of Wisconsin rose to 14.7 per cent. as contrasted with 11.3 per cent. in the three years from January, 1900, to December, 1902, and 7.9 per cent. in the three years from July, 1903, to June, 1906. That is to say, effective mortgage taxation does tend to stimulate recourse to outside lenders who are not taxable, and the exemption of mortgages, *per contra*, does operate to enhance the importance of the domestic loan; but in both cases the influence is of minor weight.

I have dwelt upon the foregoing facts because it is important to make it perfectly clear that mortgages may, under certain conditions, be taxed without bringing about shifting. The same investigation in which the foregoing facts were ascertained included in its scope a comparison

of Marinette County, Wisconsin, and Menominee County, Michigan. Michigan also has the double system of mortgage taxation, and since 1901 systematic efforts have been made to assess mortgages. In the State as a whole about $53,000,000 worth of mortgages have been placed on the assessment rolls and kept there with only slight diminution. In Menominee County, Michigan, the assessment of mortgages is not so thorough as in Clayton County, Iowa, but in all probability somewhere between 60 and 70 per cent. of the taxable mortgages in Menominee County are actually on the assessment rolls. In this county the results have been all that the opponents of mortgage taxation have predicted, as may be partially observed in the figures given on page 8. Mortgage rates have gone up a little, altho in Marinette County, Wisconsin, which is directly opposite Menominee, they have declined a little. But the principal effect of taxation is found in the prevalence of covenants in Menominee mortgages calling for the payment of taxes on the mortgage by the borrowers. Practically 60 per cent. of the mortgages contain this covenant in recent years; and the proportion of mortgages borrowed within the county of Menominee and the State of Michigan as well steadily declines: 55.6 per cent. were borrowed from mortgagees living in other States in the three years from July, 1903, to June, 1906. In Marinette County mortgage rates have not only declined, but the proportion of mortgages borrowed within the State of Wisconsin (more than 91 per cent., on an average) has steadily increased. In Menominee County, therefore, as an apparent result of mortgage taxation, mortgage rates are slightly higher than they would otherwise be, and 55 per cent. of the mortgages are obtained from mortgagees who either because of character or residence are not taxable, while the remainder of the mortgagees are amply protected by covenants in the deeds providing for the payment of all taxes by the mortgagors.

Why mortgage taxation from the standpoint of shifting and the debtor classes has proved so innocuous in Clayton and so deleterious in Menominee County is susceptible, it would seem, of fairly accurate explanation. In the first place the tax rate is low in Clayton, less than 1 per cent. (exactly 0.8) in 1906, while in Menominee County it averages $2\frac{3}{4}$ per cent. or more, 2.77 per cent. in 1906. It needs none of the niceties or complexities of minute analysis to prove that investors in Menominee will not continue to pay in taxes more than $2\frac{3}{4}$ per cent. out of the 6.60 per cent. which their mortgage loans earn, when they can get at least 4 per cent. without trouble and without risk from convenient trust companies.

In the second place, Clayton is a mature, well-developed county, in which the local supply of money is large, the demand for capital not specially keen, and land values so well fixed as to make the security of mortgage loans beyond suspicion. In Menominee County all these conditions are reversed. Much of the county is still in process of development,—cut-over timber lands to be cleared, mines to be developed. Local savings constitute a relatively small part of the capital needed to exploit the country, while land values are still speculative and land security relatively unattractive to the cautious investor. With a large supply and relatively sluggish demand for money in Clayton and a relatively small supply and keen demand for money in Menominee, the familiar laws of incidence leave no mystery in the fact that the tax is shifted in the one county and not shifted in the other. A slight contraction of the supply that in Menominee would send interest rates soaring would exercise no appreciable effect in Clayton.

On the basis of these and other facts brought out in the Wisconsin investigation it would seem reasonably safe to generalize a little about the problem of incidence pre-

sented by the double tax system. Let us assume that a vigorous attempt to assess mortgages were suddenly made in a locality in which, either by law or custom, mortgages had previously been exempt. Some contraction of the local supply of money would inevitably ensue; but this in time would be partially or completely offset by an influx of money from foreign lenders and from banks, trust companies, insurance companies, and other non-taxable mortgagees. The crucial question is, To what extent would the influx counterbalance the exodus? This depends primarily, I believe, upon the size of the tax rate, the size of mortgage rate, and the stability of land values in the district in question, the tax rate exercising a major influence upon the extent of the exodus, the mortgage rate and the stability of land values exercising a similar influence upon the extent of the influx. The districts least likely to feel a serious rise of the mortgage rate are those in which the tax rate is low and the mortgage rate fairly high,—high enough to attract the non-taxable lenders. The districts in which an increase of the mortgage rate is most likely to occur are those in which land values are uncertain—here the tax rate is likely to be high and the proportionate exodus of local money correspondingly great—and those in which the mortgage rate is so low as to offer little or no attraction to the non-taxable lender. In the undeveloped northern counties of Wisconsin, for instance, tax rates are so high that their imposition upon home loans would seriously reduce the supply of money; banks are scarce; land security is so poor that outside lenders would not venture further investments without additional premium for risk; while the demand for money is so keen and persistent that a slight net reduction of the money supply resulting from the failure of the "influx" to balance the "exodus" would considerably augment the mortgage rate. Similarly, in the wealthiest part of the

State, the east-central counties, in which the abundance of local money has brought the mortgage rate down to $4\frac{3}{4}$ per cent., the imposition of the local taxes rates, low as they are, would probably be sufficient to drive out a considerable amount of money, while non-taxable lenders would not venture in until the mortgage rate has risen to $5\frac{1}{4}$ or $5\frac{1}{2}$ per cent.[1] at least.

A rough and ready test of the likelihood of shifting at any place is found in the excess of the mortgage rate over the tax rate, the probability of shifting increasing as this excess diminishes. Other things being equal, this index varies directly as the mortgage rate, inversely as the tax rate, and, where it incorrectly indicates shifting, correctly indicates that the tax would be ineffective. In Milwaukee, for instance, the difference between the mortgage rate and the tax rate is considerably less than 3 per cent., while reputable trust companies offer 4 per cent. on money left for one year. Nevertheless, I do not believe that a mortgage tax, if imposed there, would bring about an appreciable increase in the mortgage rate. Real estate values are too stable, there are too many State banks, trust companies, and non-taxable lenders generally, and access to the general money market is too easy. On the other hand, it is even more certain that, if a tax of 2.27 per cent. were imposed upon taxable resident mortgagees (earning 4.95 per cent. on their loans), there would soon be no such mortgagees to tax. The excess of the mortgage rate over the tax rate, then, measures a mixed probability,—the probability that the tax will either be barren or be shifted.

I have applied the above test in two ways. In the first the average tax rate for each county has been subtracted from the average mortgage rate for the same county on the hypothesis that a resulting difference of less than 4 per cent. indicates in a rough way general conditions of demand

[1] *Cf.* the Wisconsin Report, pp. 369–374.

and supply favorable to shifting. In the second the average tax rate of each county has been subtracted from the various interest rates at which money was loaned in the county (for the year 1904, in which all the necessary data are available), on the hypothesis that, to the extent to which mortgage rates would be reduced below 4 per cent., to that extent investors would be forced either to shift the tax or, what is more probable, move their investments to other fields. The results according to the first test show that the excess of the mortgage rate over the tax rate was less than 4 per cent. in 36 of the 71 counties, containing 63.14 per cent. of the population of the State and representing 62.67 per cent. of the mortgage loans. According to the second test the net return to resident mortgagees, over and above taxes, would have been reduced below 4 per cent. in 62.96 per cent. of the cases.[1]

Of course, calculations of this kind must be taken *cum grano*; but, on the whole, I am inclined to believe that the last figures represent with some accuracy the extent to which double taxation of mortgages in Wisconsin would prove ineffectual or harmful.

The preceding comparison brings to view the greatest weakness of the double tax method as commonly employed. It levies upon credit instruments whose true value is shown on their face a rate of taxation maintained at an inordinately high level because of the under-assessment of other forms of property. This is not only inequitable, but it is largely responsible for such shifting of the tax as actually takes place. A mere glance at the tax rates collected in the various Wisconsin counties reveals how widely different is the quality of the assessment work and how

[1] Measuring by the amount and not by the number of mortgages. It may be worth while to add that the net return would be reduced below $3\frac{3}{4}$ per cent. in the case of 50.53 per cent. of the loans, below $3\frac{1}{2}$ per cent. in 41.06 per cent. of the loans, below $3\frac{1}{4}$ per cent. in 34.90 per cent. of the loans, and below 3 per cent. in 26.08 per cent of the loans.

impossible it would be on the face to collect such rates of taxation without inviting disaster. In the year 1904[1] average tax rates varied from .6590 per cent. in Calumet County to 4.4268 per cent. in Iron County. The average mortgage rate for Iron County in the same year was only 6.65 per cent. Under such conditions extended argument about the probable effects of hypothetical mortgage taxation is superfluous. Levy such a rate upon mortgages, and either there will be no mortgages to assess or the tax will be passed on to the debtors.

It follows, then, that, if we are to have mortgage taxation at all, the rate of taxation should be strictly limited. Better even than this, of course, would be a provision for home rule by which such counties as desired to exempt mortgages could do so. Home rule being impossible, however, both expediency and equity unite in the demand that this one form of personal property, which must be taxed at full value to be taxed at all, be protected by limitation of the tax rate. A keen and able critic has suggested that in districts such as Iron County assessors would undervalue mortgages in the same degree as other property. Such an argument to my mind is equivalent to the admission that in such districts mortgages could not be assessed. It requires unceasing pressure under any circumstances to maintain the assessment of mortgages. Assessors do not like the trouble of consulting records, usually kept at only one place in the county, in order to unearth mortgages. They must be supplied with data by supervisors of assessment, State tax commissions, or other outside agencies, if they are to assess mortgages at all. This is particularly true in the less-developed districts, where tax rates are high and, money being needed to develop the country, mortgage taxes are particularly

[1] I select that year because average rates happen to be computed. See the Wisconsin Report, pp. 77–78.

unpopular. To permit assessors, after being supplied with the facts, to scale values down which are plainly written in the bond would be suicidal. Upon this rock the double tax system of Minnesota foundered. Under the old Minnesota law, assessors were supplied by the registers of deeds with records of mortgages taxable in their respective districts. An experienced Minnesota official wrote to me: "The assessors generally pass upon the validity of the mortgage. If the mortgagee can convince the assessor that a certain mortgage has no value for taxation purposes, he passes it up, and it is not assessed. This is why the carefully framed provisions of Section 804, Revised Laws of 1905, have not succeeded in securing effective mortgage taxation in Minnesota." The only system of mortgage taxation which is at all justifiable is one in which the rate is fixed, and fixed low enough to leave small investors a net return on their loans at least equal to the interest rate paid by savings banks, trust companies, and that very restricted class of high-grade investments with which the small investor is familiar. If we must have mortgage taxation at all, the Pennsylvania system seems, on the whole, the best system now employed in any American commonwealth, altho the rate in Middle Western States, at least, might safely, in the opinion of the writer, be somewhat higher than four mills.

The Pennsylvania system, or, at least, the double tax method, with a low fixed rate, seems superior to the California method, or the recording tax, for the all-sufficient reason that it is less likely to bring about shifting. Under the California tax and under the recording taxes, practically every mortgage is taxed. By the double tax method, loans from foreign mortgagees and, usually, from banks, trust and insurance companies, both domestic and foreign, are untaxed. Tax every element of the supply, large amounts of which are almost perfectly mobile, and, accord-

ing to every theory of incidence, the mortgage rate will be raised; while the more practical, concrete investigations of Professor Plehn[1] and the New York Tax Reform Association[2] indicate that the rise will probably be fully as great as the tax itself. Tax only one element of the supply, leaving free access to an infinitely larger source, and, by reason of the very mobility of capital upon which the preceding conclusion rests, interest rates cannot be seriously affected. There is not only unimpeded access to the national money market, but in Wisconsin at least there is unimpeded access (or was under the old law) to domestic banks, trust and insurance companies, and building and loan associations. How, under such circumstances, could the mortgage rate be raised 1.5 per cent. (the average rate of taxation throughout the State) by reason of taxation? It is true that the recording tax yields more, but it purchases productivity at the expense of the debtor, and, if the debtor foots the bill, the more productive the tax, the worse it becomes. It would be far better to exempt mortgages and secure the additional revenue by raising the general tax rate.

It is also true that the double tax method shields the debtor at the expense of the yield: it prevents the tax from becoming unbearable by making it partially ineffectual. But only *partially* ineffectual. There is a class of investors in mortgages—and in well-developed agricultural communities a very important class—who will pay a moderate tax rather than send their money outside of the State or change the form of their investment. They know the security of real estate in their own immediate neighborhood, and this is about the only class of securities of which they have any knowledge and in which they repose any real confidence. Frequently they make their

[1] Yale Review, May, 1899.

[2] Mortgage Taxation and Interest Rates, published by the New York Tax Reform Association, 1906.

loans when they sell their own land, taking a low interest rate, getting a high price, often mortgaging the property to a much higher proportion of its value than any outsider would consent to do, because "it used to be theirs, and they know what it's worth." Such loans, the so-called purchase money mortgages, must remain within the State; they constitute an integral part of the process by which land values are raised. The small investor of the class here described is not easily affected by minor variations of the interest rate. He wants his money to earn as much as possible, to be sure, but he is far more concerned about its security than its exact earning power. It is investors such as this, who own the three million dollars' worth of moneys and credits, mostly mortgages, which Clayton County, Iowa, keeps on its assessment rolls from year to year, who own, for the most part, the fifty-three million dollars' worth of mortgages which Michigan has on its tax rolls. It is this typical mortgagee whose existence and importance has been overlooked by those economists who confidently assume that any tax upon mortgages will inevitably be shifted. As a matter of fact, and particularly in agricultural communities, the supply of money seeking mortgage investment is far more persistent, far less mobile, far less elastic, than the average writer would have us believe. As a fiscal officer of great ability and long experience in one of the most important American commonwealths writes to me: "Some contend that the taxation of mortgages on a par with other property would result in an increase in the interest rate, but I do not think so. There is so much money seeking investments of that nature that I cannot believe that the interest rate would be affected thereby."

But, must we, after all, have any kind of mortgage taxation? Is it worth while to tax the small capitalist, who invests at home, and who has not the training to

invest safely either in other States or in other securities, by a method which actually facilitates the escape of the more important creditor who knows how to invest in other States, or in the large number of practically untaxable securities available to men of wide financial experience? Certainly, the answer must be negative, it is not worth while, if the successful taxation of the one is to hide the escape of the other, if in the clamor over mortgage taxation we are to shut the ears of the electorate to the open failure of the general property tax to reach some of the most conspicuous forms of tax-paying ability. After all is said, the taxation of mortgages must, in most commonwealths, remain a comparatively trivial affair. Suppose, for instance, the State of Wisconsin should—at considerable administrative expense and at the cost of some shifting in the undeveloped portions of the State—add one hundred million dollars' worth of mortgages to the assessment rolls (and more could hardly be added), the taxable basis of the State would be increased less than 7 per cent., and if, as has been shown to be necessary, taxation upon mortgages were limited to, say, $\frac{1}{2}$ of 1 per cent., this would be equivalent to increasing the total assessment by little more than 2 per cent. Mortgage taxation of this kind, therefore, can never be an issue of first importance, never constitute a primary reform. To delay, even so much as a year or two, the introduction of that substitute for the personal property tax which is bound to come, by dallying with such a trifling diversion, would be unwise.

And yet we must add another qualification. There are communities in which no sweeping reform of the personal property tax in the near future is conceivable. In such communities I do not see how a valid case can be made out against mortgage taxation of a proper type. Certainly, no valid objection lies in the criticism that the method of mortgage taxation here contemplated involves

double taxation. There are many forms of justifiable double taxation; and if, as experience has amply demonstrated, it is impracticable to exempt the mortgage debtor upon the amount of his debt, then the least we can do for him is to lighten his load a little by placing mortgage credits upon the assessment rolls. Surely, the creditor in this case should be the last to raise a protest on the score of equity.

Furthermore, it is idle to urge that what the State wants is taxation of property, it being no business of the State who pays the taxes. This argument is misleading and wrong in many ways. It is sufficient here to point out in answer that the creditor frequently lives in a county or assessment district different from that in which the property is situated. When the tax-payers of district A complain that Mr. Doe is escaping taxes on his mortgage, their complaint cannot be silenced by the reply that the property is taxed at its full value in assessment district B. That avails the good people of A nothing. This mortgage tax is a personal tax, designed to touch the tax-paying ability of creditors in the communities in which they live, breathe, and have their social being; and, as I see the question, it is absolutely unaffected by the familiar arguments brought forward by advocates of the exemption of credits. The tax upon property satisfies the demand for taxation of property *in rem.* What the mortgage tax attempts to do is to supply in an imperfect way a part of the legitimate demand for taxation *in personam.*

Nor is it a fatal objection to the kind of mortgage taxation here described that it catches the small fry and lets the large fish escape. Relative to capitalists and investors generally, the mortgagee who can be taxed is, indeed, a modest citizen; but compared with the general body of tax-payers, the great mass of people who own encumbered property, this mortgagee is a good-sized fish.

The average mortgage creditor probably ranks well above in tax-paying ability the median tax-payer.

We return, in conclusion, to that aspect of the subject with which the paper opened,—the conflict between economic doctrine and legislative practice. If the preceding analysis has been fairly correct, the honors of the conflict lie as much with the legislator as with the economist. Both are right, the legislator in insisting that some mortgages may be taxed without shifting, the economist in his contention that the whole personal property tax is a failure. For, after all, this is what the economist has been insisting; and it is because he has not consciously realized the trend of his own thought that he is fairly open to criticism. He has been saying to the legislator, with a strong note of criticism in his lecture, "Mortgage taxes will be shifted: therefore, mortgage taxes are bad." That argument the legislator could not understand,—could not understand because he knew it was untrue. Omitting Professor Plehn's study of the California mortgage tax, a thorough-going investigation of a system which is *sui generis* and in many respects throws no light upon the mortgage problem in other States, it is perfectly fair to say that the academic economists *qua* economists have written very little on this subject which is worthy of the name of science. Their arguments have been far below, and not at all over, the heads of the better class of legislators in the more progressive States. The aim of the economist has been a good one; but he has employed bad arguments to plead his cause. Unless I am very much mistaken, the syllogism which he has really had in mind is this. The personal property tax is vicious, mortgages are personal property: *ergo*, mortgage taxation is vicious. And to that argument most of us will heartily say, Amen.

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